



UPGRADING TO AN ENCRYPTED TAX STAMP SOLUTION WILL IMPROVE MICHIGAN'S TOBACCO REVENUE COLLECTION AND REDUCE ILLICIT TRADE

FAQ

HOW EXTENSIVE IS MICHIGAN'S ILLICIT TOBACCO TRADE MARKET?

According to the Tobacco Merchant's Association (TMA) cigarette sales volume report, Michigan has lost 40% of its stamp volume (measured in packs of cigarettes) in the last 10 years, from 810 million packs in 2000 to only 486 million packs in 2010. Michigan has experienced the 6th largest volume drop over the last decade – this translates to less tax revenue. Strong evidence suggests that the significant decline is not the result of smoking cessation alone. The Michigan state cigarette use rates from the U.S. Centers for Disease Control and Prevention (CDC) estimates the average cessation rate is 3.5% per year. Based on legal cigarette pack sales and smoking rates provided by the Department of Health, we estimate that in just the last 5 years, ***Michigan lost out on more than \$1.1 billion in tax revenue that should have been collected on cigarettes sold in the state.***

HOW DOES THE STATE'S CURRENT TAX STAMPING SYSTEM MAKE IT VULNERABLE TO ILLICIT TRADE?

The Department of Treasury does not currently have adequate and reliable tobacco statistics to evaluate the problem. Along with many other states, Treasury relies mostly on volume reports communicated by state distributors. The state has little to no visibility of distributor activity and of tobacco brands being sold in the state. An effective monitoring and automatic reporting system will build an accurate analysis of what is actually being sold and consumed. A robust tax collection solution will reduce counterfeiting and contraband, and provide accurate reporting requirements needed for ensuring correct Tobacco Master Settlement Agreement (MSA) payments.

WHAT ARE THE FLAWS IN MICHIGAN'S CURRENT TAX STAMP SYSTEM?

The FUSON® heat-transfer stamp has long provided an easily applied, cost-effective means for states to collect cigarette tax revenues. Meyercord Revenue, acquired by SICPA in 2010, has provided the FUSON® stamp to Michigan for over 13 years. However, as advances in technology have enabled more sophisticated copying and counterfeiting capabilities, the ability of the FUSON® product to deter counterfeiting of tax stamps has reached its limit.

Additionally, FUSON® stamps can only be applied to cellophane wrapped cigarettes packs leaving countless Other Tobacco Products (OTP) unstamped. The lack of markings or stamps on OTP renders this class of product highly susceptible to the evasion of taxes.



WHAT IS THE ENCRYPTED TAX STAMP SOLUTION?

The high-tech encrypted tax stamp serves as a platform for the authentication, monitoring, tracking and tracing of cigarette products subject to counterfeiting, tampering, smuggling and tax evasion. This solution is more than just a tax stamp.

SICPA's encrypted stamp solution relies on two types of security: 1) material-based security features, and 2) information-based security features, which covertly stores information critical for enforcement, auditing and Tobacco Master Settlement Agreement (MSA) reconciliation efforts.

Integrating robust overt features into the encrypted stamp allows for anyone to identify counterfeit stamps by simple 'naked-eye' visual inspection without the aid of any tools or devices.

For material-based security of semi-covert and covert stamp features, SICPA offers a wide range of innovative, simple devices that allow the State's enforcement agents and investigators to instantly differentiate between authentic and counterfeit stamps. Depending on the requirements of the State, these devices range from filters and lights to advanced yes/no scanners.

For information-based security, SICPA offers specialized law enforcement readers, solely available to governments. These readers reveal and capture the covert encrypted information encoded on the stamp, enabling tracking and tracing of cigarette packs from stamp production to distributor activities. Distributor to retailer product flow information can also be acquired should the state require it. The information is centralized and translated into actionable reports that the state can utilize to better plan and enhance enforcement and investigative activities.

WHAT RESULTS CAN MICHIGAN EXPECT?

A state that implements an encrypted stamp can expect the following, proven results:

- **A significant reduction in illicit tobacco trafficking**

By providing an unparalleled level of product security and introducing real-time visibility to product tracking, an encrypted stamp severely hinders tax evasion efforts.

- **Enhanced tax revenues**

By facilitating the recovery of taxes due to governments and protect these from being diverted.

- **MSA reconciliation support**

By storing information in a state-owned centralized database about every cigarette pack shipped in a state and its movement along the supply chain, which provides an accurate count of product for MSA reconciliation.

- **Protected public health**

- By detecting counterfeit "tax-unpaid" consumer products in circulation and enabling more revenues to be used for tobacco cessation programs, the upgraded technology allows a state government to better preserve the health of its constituents.

- By extending the tax stamp technology to "other tobacco products" (OTP) including little cigars, snus, etc., states are able to effectively reduce the dramatic price disparities between cigarettes and OTP. Higher prices on all tobacco products help to prevent youth nicotine addiction. The growing under-priced OTP market is attracting more youth tobacco users.



HOW CAN SICPA DELIVER THESE RESULTS IN MICHIGAN?

The system achieves these results by making critical upgrades to a state's existing tobacco excise tax and recovery system, including:

- 1) providing a next-generation, counterfeit-resistant tax stamp;
- 2) incorporating an efficient track and trace system that provides unprecedented visibility of each product as it moves through the supply chain;
- 3) providing law enforcement personnel and auditors with the tools and training to effectively and efficiently use the system.

WHAT IS THE ANTICIPATED RETURN ON INVESTMENT TO THE STATE FROM CAPTURING THIS LOST REVENUE?

Government entities using SICPA's encrypted tax stamp have seen return in as little as two months and at rates ranging from 20% to 70% of diverted revenue recovery. SICPA's encrypted tax stamp solution is highly reliant on enforcement activities and strict penalties for illicit trade. Although it is the essential piece of the three pronged approach for tax recovery, the system requires an extensive commitment from the state to ensure its effectiveness.

We realize that not all states are in a position to heavily invest in auditing and enforcement manpower. As a result, SICPA is open to discuss audit and investigation assistance services with the state that can greatly benefit the overall revenue impact of the encrypted tax stamp solution.

